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No. 98-1065

IN THE
# Supreme Court of the United States
OCTOBER TERM, 1998

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INDIANAPOLIS POWER & LIGHT COMPANY,
*Petitioner,*

v.

PENNSYLVANIA PUBLIC UTILITY COMMISSION
and PECO ENERGY COMPANY, *et al.*,
*Respondents.*

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**On Petition for Writ of Certiorari to the Commonwealth Court of Pennsylvania**

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## BRIEF IN OPPOSITION OF RESPONDENT PENNSYLVANIA PUBLIC UTILITY COMMISSION

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## QUESTION PRESENTED

Whether it was a violation of the Commerce Clause of the U.S. Constitution for the Pennsylvania Public Utility Commission to allow an electric utility to recover costs associated with the transition to a competitive market for retail sales of electricity when these expenditures had previously been found to have been prudently incurred and recovery of those costs was placed on all customers regardless of whether they purchased electricity from that utility, other Pennsylvania utilities, or other electric generators located within and without the Commonwealth.

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## BRIEF IN OPPOSITION OF RESPONDENT PENNSYLVANIA PUBLIC UTILITY COMMISSION

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### STATEMENT OF THE CASE

Respondent Pennsylvania Public Utility Commission accepts the Statement of the Case as set forth by Respondent PECO Energy Company in its brief in opposition.

### SUMMARY OF ARGUMENT

In bringing this request for a writ of *certiorari*, IPL seeks to re-litigate issues which it lost before the Pennsylvania Public Utility Commission, Commonwealth Court

and the Pennylvania Supreme Court. IPL Offers no reason which would meet the test established by Supreme Court Rule No. 10 and compel this Court to give it another bite at the apple.

It does this by disregarding the nature of the Customer Choice Act and its recognition of the costs of making the transition from a fully regulated environment to one in which the sale of electricity within Pennsylvania will be made in a competitive market. State regulated electric utilities will continue to provide regulated monopoly distribution and transmission services; however, they will now have to compete with each other, as well as with independent generators both inside and outside the Commonwealth when making sales of electric power. Thus, all Pennsylvania consumers will have the ability to choose their supplier of electricity.

However, in 1996, when the General Assembly passed and the Governor signed Pennsylvania's Electricity Generation Customer Choice and Competition Act, the provision of electric service by investor-owned utilities was still fully regulated. As such, these utilities had made prudent investments in facilities to serve the present and future needs of their customers under the obligations imposed by both state and federal law. Not all of the costs of these investments could be recovered in a competitive market. As a recognition of these expenditures made for the benefit of utility customers, the Customer Choice Act allowed electric utilities to recover these expenses over a temporary period of time and after reasonable mitigation measures have been taken.

IPL incorrectly calls this a "subsidy" and claims it violates the Commerce Clause of the Constitution. It is by no means a subsidy and it does not discriminate against interstate commerce. Moreover, the Pennsylvania Commonwealth Court recognized that the transition cost recovery provisions of the Act comport with, and in most respects mirror, current federal regulatory practice as well

as that of other states which are making the transition to an open market.

Collection of these costs poses no burden on interstate commerce and is not discriminatory. The Court should deny the request for a writ of *certiorari.*

## REASONS FOR DENYING THE WRIT

### I. INTRODUCTION

Indianapolis Power and Light Company (IPL), an electric utility licensed by the State of Indiana to serve customers in the Indianapolis area, challenged Pennsylvania's Electricity Generation Customer Choice and Competition Act [1] by claiming that allowing a utility to recover the prudently incurred costs of its transition from a regulated to a competitive market violates the Commerce Clause of the U.S. Constitution.[2] Commonwealth Court rejected IPL's arguments, holding correctly that the Customer Choice Act, specifically the provisions which allow a utility to recover its costs of transition from regulation to competition, do not discriminate against interstate commerce. *Indianapolis Power & Light Co. v. Pennsylvania Public Utility Commission,* 711 A.2d 1071 (Pa. Commonwealth Ct. May 7, 1998); Pet. App. 1a-38a. Instead of impeding commerce, the court held that the transition, or stranded, cost recovery provisions of the Act were an integral part of opening the market for electricity to competition in the Commonwealth. Moreover, IPL was unable to convince the Pennsylvania Supreme Court to review that decision. Pet. App. 145a.

The unanimous *en banc* decision of the Pennsylvania Commonwealth Court which IPL now seeks to bring before this Honorable Court for further review, addressed

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[1] 1996, Dec. 3, P.L. 802, No. 138, § 4 effective Jan. 1, 1997; codified at 66 Pa. C.S. §§ 2801-2812; Pet. App. 146a-231a, (Customer Choice Act or Act).

[2] U.S. Const., Art. III.

and rejected each of the arguments IPL proffered in support of its legal theory that recovery of transition costs would violate the Commerce Clause. The decision of Commonwealth Court affirms Pennsylvania's Customer Choice Act as being in harmony with regulation in virtually all states which are in the process of introducing competition in the sale of electricity as a means of lowering the cost of energy to consumers. Commonwealth Court correctly recognized that the Customer Choice Act was a lawful exercise of the state's authority to regulate the sale of electricity and not, in any way, in conflict with the Constitution, federal laws or the decisions of this or other courts.

## II. THE HOLDING OF COMMONWEALTH COURT AFFIRMING THE LAWFULNESS OF THE CUSTOMER CHOICE ACT IS IN HARMONY WITH DECISIONS OF OTHER COURTS

IPL has challenged the PUC's order granting approval, in part, for PECO Energy to issue transition bonds pursuant to section 2812 of the Act, claiming that the PUC's order, and the Commonwealth Court decision affirming that order, violate the Commerce Clause of the U.S. Constitution in that it places out-of-state competitors of Pennsylvania utilities at a competitive disadvantage in competing for customers, thus creating an impermissible burden on intertate commerce.

As the court held, the Customer Choice Act in no way violates the Commerce Clause of the Constitution by acting as a means of protecting Pennsylvania utilities. To the contrary, the Customer Choice Act opened the provision of electric energy to retail purchasers of electricity to competition from Pennsylvania and non-Pennsylvania generators. Moreover the Act's provisions, that allow utilities to recover prudently incurred transition costs, which would otherwise be lost to the utility through the introduction of competiiton into retail sales of electricity are a necessary element of making the transition to a com-

petitive market. These costs are recovered from all customers regardless of who supplies them with electricity. The necessity for and manner of recovery comports with practices being adopted in other states, as well as those of the federal government as expressed through the orders of the Federal Energy Regulatory Commission (FERC), and as affirmed by the U.S. Court of Appeals.

### A. The Pennsylvania Customer Choice Act

The introduction of competition into the retail sale of electricity had not been feasible in the past in part due to statutory barriers to the transmission of power contained in the Federal Power Act.[3] This effectively prevented anyone, with few exceptions, from selling power into the system of a local electric utility. However, the Energy Policy Act of 1992[4] amended the FPA making it easier for FERC, which regulates the wholesale market for electric power, to order one utility to transmit, or "wheel," power into or across its system on behalf of another party. As described below, FERC has issued regulations which require electric utilities to separate, or "unbundle," the sale of electricity from the transmission of power in wholesale transactions. Thus, the utility must sell the transmission of electricity and the electricity itself as separate services. This makes it possible for a generator, marketer or other seller of electric power to produce that power in one place and move it across one or more electric systems before selling the electricity to another utility.

The seller may also sell directly to an end-use customer in a utility's service area if that utility is open access and provides distribution only service. In short, the utility allows a customer to buy power from another source and the utility charges the customer for transmitting the power to its point of use. By and large, this is only possible in a

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[3] Federal Power Act, 16 U.S.C. § 791a *et seq.* (FPA).

[4] Energy Policy Act of 1992, Pub. L. 102-486, 106 Stat. 2776.

state which has adopted some form of open access for electric utilities.

Pennsylvania did that with the Customer Choice Act which was enacted by the General Assembly and signed by Governor Tom Ridge late in 1996. It became effective January 1, 1997. The legislation grew out of a PUC report made earlier in 1996 to the Governor.[5] The Competition Report was the culmination of a two-year study of the potential benefits and detriments which might be realized through the introduction of competition in the retail market for electricity which was then fully regulated by the Commonwealth through the Public Utility Commission.

In the Competition Report, the Commission found that, on average, rates for electricity in Pennsylvania were among the highest in the nation. Competition Report, p. 5; PECO Energy App. 1a-3a. Additionally, there were disparities among rate levels in different parts of the Commonwealth. *Id.* Perhaps more importantly, the PUC found that the marginal cost of electricity was considerably lower than existing retail rates, due primarily to "reduced capital cost, improved production efficiencies, and favorable oil and gas prices." *Id.* When these factors are combined with changes in federal energy policy such as the enactment of the Energy Policy Act of 1992, more lower-cost generation became available than had hitherto been the case.

In order to make this less expensive generation available to customers within the Commonwealth, the PUC recommended that retail customers be allowed to purchase electricity from generation suppliers other than their

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[5] *Investigation Into Retail Competition*, Docket No. I-940032, Report and Recommendation to the Governor and General Assembly on Electric Competition, July 1996 (Competition Report). Pertinent parts are reproduced in the Appendix of PECO Energy; PECO Energy App. 1a-20a.

native utility. In short, the Commission found that the industry should be restructured to permit competition among electric generators. It proposed a plan for implementation of competition which would be phased-in over a period of years. However, the PUC recognized that such a dramatic change in the industry would also lead to potentially serious problems.

One of the foremost of these was that of stranded costs. The PUC noted that:

> If consumer prices are to be based on market prices instead of regulated rates, market prices may not be sufficient to recover all existing utility investments and expenses. In general terms, costs currently included in rates which exceed the market value of the related asset are uneconomic. Upon the transition from regulated rates to market-based prices, uneconomic costs may become stranded to the extent that they are not recovered by market prices. These costs are in the regulated rates that consumers pay today, although they are not explicitly identified as stranded costs.

*Id.* at PECO Energy App. 3a.

The Commission found that the existing utility cost structure contained four categories of costs, which could become stranded. These were (1) regulatory assets such as deferred taxes and post-retirement employee benefits, (2) non-utility generation contracts, including contracts to purchase electricity from qualifying facilities pursuant to the Public Utility Regulatory Policies Act of 1978 [6] which required electric utilities to purchase power from certain types of independent generators, (3) utility generation assets, and (4) nuclear decommissioning costs. *Id.* at PECO Energy App. 3a-4a.

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[6] Public Utility Regulatory Policies Act of 1978, Pub. L. 95-617, 92 Stat. 3117.

The PUC recommended that the General Assembly include authority in any restructuring legislation which would allow the Commission to approve recovery of utility net stranded costs provided that the utility had followed a rigorous program of mitigating those costs. It found that, although it was not required to guarantee recovery of 100 percent of all stranded costs, fairness dictated that utilities were entitled to a reasonable opportunity to recover their net stranded costs. *Id.* at PECO Energy App. 18a-20a.

The Customer Choice Act, approved by the General Assembly later that year, did contain such provisions. The legislature found that:

> In establishing the standards for the transition to and creation of a competitive electric market, heretofore, public utilities generally have had an obigation to serve customers within their defined service territories; consistent with that obligation, have undertaken long-term investments in generation, transmission and distribution facilities in order to meet the needs of their customers, and have entered into long-term supply power supply agreements as required by federal law. In many instances these investments and agreements have created costs which may not be recoverable in a competitive market. The Commission is empowered under this chapter to determine the level of transition or stranded costs for each electric utility and to provide a mechanism, the competitive transition charge, for recovery of an appropriate amount of such in accordance with the standards established in this chapter.[7]

66 Pa. C.S. § 2802(15); Pet. App. 150a.

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[7] "TRANSITION OR STRANDED COSTS." An electric utility's known and measurable net electric generation-related costs, determined on a net present value basis over the life of the asset or liability as part of its restructuring plan, which traditionally would be recoverable under a regulated environment but which may not be recoverable in a competitive electric generation market and which the commission determines will remain following mitigation by the electric utility. 66 Pa. C.S. § 2803. Pet. App. 156a.

The Customer Choice Act also included a provision whereby utilities could further mitigate stranded or transition costs by obtaining a "qualified rate order" from the Commission pursuant to 66 Pa. C.S. § 2812; Pet. App. 213a-31a, which would allow the utility to sell, assign or otherwise transfer intangible transition property. This enables a utility to issue a transition bond which, in effect, securitizes the asset. Because of lower interest rates today than when these assets were created and other factors, transition bonds can reduce a utility's overall rates. The Commission order below is a qualified rate order; however, IPL's challenge was directed at the recovery of transition or stranded costs and not specifically at QROs.

**B. Recovery of Stranded Costs in Other Jurisdictions**

Pennsylvania is by no means the only jurisdiction that allows recovery of stranded costs as part of the transition to a competitive market for energy. In 1992 FERC issued Order No. 636 [8] which required interstate natural gas pipelines to unbundle their sales, storage and transportation services. Prior to that time local gas utilities and other pipeline customers had been able to purchase natural gas directly from pipelines as a bundled service. The pipeline would acquire gas from its own production facilities or buy it from producers in the production fields and use its pipeline to transport that gas to the customer, using storage facilities, if necessary.

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[8] Order No. 636, *Pipeline Service Obligations and Revisions to Regulations Governing Self-Implementing Transportation; and Regulation of Natural Gas Pipelines After Wellhead Decontrol*, Fed. Energy Reg. Comm'n Stats. & Regs. [Regs. Preambles 1991-1996] (CCH) ¶ 30,939, *order on reh'g*, Order No. 636-A, Fed. Energy Reg. Comm'n Stats. & Regs. [Regs. Preambles 1991-1996] (CCH) ¶ 30,950, *order on reh'g*, Order No. 636-B, 61 F.E.R.C. ¶ P61,272 (1992), *reh'g denied*, 62 F.E.R.C. ¶ 61,007 (1993), *aff'd in part and remanded in part, United Distribution Companies v. FERC*, 88 F.3d 1105 (D.C. Cir. 1996), *cert. denied*, 137 L.Ed.2d 845, 117 S. Ct. 1723 (1997).

Through Order No. 636, FERC directed that in the future all three services would have to be separately tariffed. It is also notable that FERC did not require pipelines to abandon their merchant services, although most have done so, leaving that task to marketing affiliates. FERC did see the necessity for allowing recovery of stranded costs and did permit pipelines *full* recovery. This action was upheld by the U.S. Court of Appeals for the District of Columbia Circuit on appeal. *United Distribution Companies v. FERC,* 88 F.3d 1105 (D.C. Cir. 1996), *cert denied,* 117 S. Ct. 1723 (1997). Many of the petitioners challenging Order No. 636 were natural gas producers or marketers independent of the pipelines. Although it may not have been in their individual self interest to do so, they recognized the necessity of allowing recovery of legitimate pipeline expenditures which could not be recovered in a competitive market. Moreover, this Court has recognized the applicability of decisions under the Natural Gas Act [9] to legal questions regarding the administration of the Federal Power Act and *vice versa.*

> Montana-Dakota Utilities was a case under the Federal Power Act rather than under the Natural Gas Act, but as we have previously said, the relevant provisions of the two statutes "are in all material respects substantially identical." *FPC v. Sierra Pacific Power Co.,* 350 U.S. 348, 353 (1956). In this opinion we therefore follow our established practice of citing interchangeably decisions interpreting the pertinent sections of the two statutes. See, e.g., ibid.; *Permian Basin Area Rate Cases,* 390 U.S. 747, 820-821 (1968).

*Arkansas Louisiana Gas Co. v. Hall,* 453 U.S. 571, 577 n.7, 101 S. Ct. 2925, 2930 n.7 (1981).[10] Based on these

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[9] Natural Gas Act, 15 U.S.C. § 717 *et seq.* Order No. 636 was promulgated under the Natural Gas Act.

[10] It is possible that the constitutionality of stranded cost recovery could reach this court through appeals of Order No. 888. The

cases the Court should consider the question of stranded cost recovery at the federal level as settled.

This can be illustrated by the fact that, in directing electric utilities to similarly unbundle their electric sales and transmission services, FERC again recognized that providing recovery of stranded costs was an essential part of bringing competition to energy sales:

> We reaffirm our preliminary determination that the recovery of legitimate, prudent and verifiable stranded costs should be allowed. . . .
>
> [W]e do not believe that utilities that made large capital expenditures or long-term contractual commitments to buy power years ago should now be held responsible for failing to foresee the actions this Commission would take to alter the use or their transmission systems in response to the fundamental changes that are taking place in the industry.

Order No. 888,[11] mimeo at 452-53. More specifically

> Order 888 permits stranded cost recovery from customers who terminate their wholesale service where the costs are "legitimate, verifiable and prudent." To obtain such recovery, jurisdictional utilities must satisfy a "heavy burden" that they had a "reasonable expectation" of continuing to provide service to departing customers for some period beyond the termi-

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Pennsylvania Commission submits that, if the Court believes that it needs to address this issue, a federal regulatory proceeding with national implications is the better case to review.

[11] Promoting Wholesale Competition Through Open Access Non-Discriminatory Transmission Service by Public Utilites; Recovery of Stranded Costs by Public Utilities and Transmitting Utilities, Final Rule, Order No. 888, 61 Fed. Reg. 21,540 (1996), FERC Stats. & Regs. ¶ 31,036 (May 10, 1996) (Order No. 888); *clarified*, 76 FERC ¶ 61,009 *and* 76 FERC ¶ 61,347 (1996), *order on reh'g*, Order No. 888-A, 62 Fed. Reg. 12,274 (Mar. 14, 1997), III FERC Stats. & Regs. ¶ 31,048 (1997) (Order No. 888-A), *order on reh'g*, Order No. 888-B, 62 Fed. Reg. 64,688, 81 FERC ¶ 61,248 (1997), *order on reh'g*, Order No. 888-C, 82 FERC ¶ 61,046 (1998).

> nation date and must further show that the claimed stranded costs were directly and proximately caused by FERC's open-access directive. Stranded cots are measured as the difference between revenues received during the prior three years of service under the contract (or during the prior most recent year if contract rates have changed) and the estimated market value of the capacity and energy involved. The latter may be estimated on the basis of pricing studies, a brokered sale by the customer of its former supply or by employing the customer's new power supply as a proxy for this value. The cost may be recovered either through an exit fee or by means of a surcharge imposed on future transmission service provided to the customer.

Hall, *Securitization and Stranded Cost Recovery,* 18 Energy L.J. 363, 367 (1997); footnotes omitted. FERC has reaffirmed its determination to allow recovery of stranded costs in subsequent orders.[12]

FERC has also encouraged the states to address this matter as they considered unbundling at the retail level:

> [T]he states have a number of mechanisms for addressing stranded costs caused by retail wheeling, one of which is a surcharge to state-jurisdictional rates for local distribution. We encourage the states to use the mechanisms available to them to address stranded costs.

Order No. 888, mimeo at 541.

Nor is Pennsylvania the only state which provides for the recovery of stranded costs as part of the introduction of competition for retail electric services. In total, 13 states, including Pennsylvania, California, Illinois and Michigan, now have legislation which provides for the

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12 Order No. 888-A, III FERC Stats. & Regs., *id.* at 30,348, 30,353-58.

restructuring of the electric industry to some degree.[13] At least eight others, including Texas and New York, have initiated programs sponsored by the respective state regulatory commissions or, in some cases, by utilities themselves. *Id.* In adopting legislation opening the retail sale of electricity to competition, the California legislature also found that recovery of stranded costs was a necessary condition to implementing competition.[14] Cal. Public Utilities Code § 330(s) (1996).

Many of these states also allow the use of securitized assets to reduce the impact of stranded cost recovery.

> Currently, California, Pennsylvania, Montana, Illinois, Massachusetts, Rhode Island, and Connecticut have adopted legislation that allows utiities to use this option and other states are considering it. In December 1997, three investor-owned utilities in California issued a total of $6.1 billion in securitized bonds (these companies have been authorized by the California Public Utilities Commission to issue up to $7.3 billion).

Kenneth Rose, *Brief Overview Of Securitization,* the National Regulatory Research Institute, the Ohio State University; PECO Energy App. 21a-24a.

Thus, Pennsylvania is in the mainstream of modern practice with respect to regulation of the electric indus-

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[13] *1998 Annual Report*, Section of Public Utility, Communications and Transportation Law, American Bar Association, pp. 189-96; National Regulatory Research Institute, Survey on Electric Industry Restructuring, Electric Industry Restructuring Box Score, www.nrri.ohio-state.edu. The NRRI is the research arm of the National Association of Regulatory Utility Commissioners.

[14] The California legislation contains provisions for the issuance of "Rate Reduction Bonds," similar to Pennsylvania's QROs. Cal. Public Utilities Code §§ 840-44.

try.[15] The Customer Choice Act can hardly be said to conflict with federal regulations or the laws of a growing number of states that have decided to introduce competition into utility regulation.

Commonwealth Court recognized this when it said:

> We are also convinced that the implementation of stranded-cost recovery mechanisms in other forums is compelling evidence that the Commerce Clause should not be used to hinder Pennsylvania's experiment with competitive electric generation. The move toward competitive utility markets is a national trend, and the recovery of stranded-costs is by no means isolated to the Competition Act. Those regulatory bodies, both federal and local, whose expertise has been relied on to facilitate the move toward open markets, seem to agree that the need for these recoveries is essential. As such, we are compelled to defer to PUC's decision to model Pennsylvania's move toward competition after these other forums, and we see no justification for implicating the Commerce Clause in derailing this ambitious endeavor.

*IPL v. PUC,* Pet. App. 22a-23a; footnote omitted.

In arguing that the Customer Choice Act violates the commerce clause, IPL ignores some important factual distinctions between the Pennsylvania Act and the Massachusetts law which is at the heart of its argument—*West Lynn Creamery, Inc. v. Healy,* 512 U.S. 186 (1994). *West Lynn Creamery,* cited throughout IPL's Petition, involves a very different industry. In that case, this Court struck down a Massachusetts Department of Food and Agriculture pricing order which created a "premium" on the price of milk sold in that state. *West Lynn Creamery,* 512 U.S. at 188-91.

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[15] For example, a Michigan court recently upheld the decision of that state's regulatory commission to introduce an electric competition pilot program. *Detroit Edison Co. et al. v. Michigan Public Service Commission,* 227 Mich. App. 442, 1998 Mich. App. LEXIS 15 (1998).

The Massachusetts premium involved an attempt to protect local industries by providing premiums above market prices. These premiums had no relation to *past* investment made by a state-licensed public utility in a fully regulated environment. The pricing order created a formula for the fixing of the premium which was to be assessed on a per unit basis on all producers selling milk in Massachusetts. *Id.* This included out-of-state as well as local producers. The revenues collected were placed into a fund from which payments were made to Massachusetts producers. This Court held that the arrangement gave Massachusetts producers of milk an advantage over out-of-state producers which created an impermissible burden on interstate commerce. *Id.* at 194.

IPL ignores the central distinction between the *West Lynn Creamery* pricing order and Pennsylvania Customer Choice Act. The allowance of recovery of stranded costs in no way amounts to, or compares with, the payment of artificially created premiums. Electric utilities in Pennsylvania made investments concomitant to their responsibilities to provide electricity on a safe and reliable basis to customers within their service territories under the state's long-standing regulatory regime. They have also had to enter into contracts to purchase electric power pursuant to government direction under the Public Utility Regulatory Policies Act of 1978 from independent power producers.

The stranded, or transition, costs an electric company recovers from its customers represent the return of the utility of its investment which, as a result of the change to a competitive market, it can no longer recoup. These costs are not subsidies, but rather recoupment of amounts the utility prudently spent on behalf of its customers. Amounts which, for the most part, have already been approved in prior PUC rate case orders. The investments now being recovered in Pennsylvania and other states were made due to obligations imposed by state and federal

laws and regulations. Moreover, the recovery of this investment is limited to a specified period of time and is not a permanent feature. *See* 66 Pa. C.S. § 2804(4)(i)(B)(ii), Pet. App. 162a.

Thus, recovery of stranded investment is a cost of making the transition to an open market for the sale of electricity and does not represent an impediment to interstate commerce. It is, in fact, an integral part of the creation of a market which heretofore did not exist. As the Pennsylvania Commonwealth Court correctly observed:

> Severing these [stranded cost recovery] provisions is in our minds implausible since they were regarded as so essential to the transition toward competition envisioned by the General Assembly and are so interwoven with the local utilities' continuing obligation to maintain transmission and distribution networks.

*IPL v. PUC*, Pet. App. 36a.

### C. The Customer Choice Act Does Not Trigger the Dormant Commerce Clause

If a state law reaches out to the extent that it touches interstate commerce, it potentially triggers the *dormant* Commerce Clause. The dormant aspect of the Commerce Clause prevents actions by states to protect local economies by burdening out-of-state competitors. *New England Co. of Indiana v. Limbach*, 486 U.S. 269, 273 (1988).

> The Commerce Clause has a negative or dormant aspect which limits the power of the states to erect barriers against interstate trade *where Congress has not affirmatively acted* to either authorize or forbid the challenged state activity. . . . The dormant Commerce Clause doctrine serves to prevent a state from regulating business in such a way as to provide unfair advantage to its own residents at the expense of residents of another state.

*Empire Sanitary Landfill v. Commonwealth*, 546 Pa. 315, 332-33 (1966); (emphasis supplied). As noted above,

FERC, acting on the authority granted it by Congress through the Federal Power Act, has expressly encouraged the states to provide for recovery of stranded costs:

> We encouraged the states to use the mechanisms available to them to address stranded costs. . . .
>
> [T]he Commission intends to be respectful of state objectives so long as they do not balkanize interstate transmission of power or conflict with our interstate open access policie.

Order No. 888, p. 541-43.

Such an affirmative expression indicates the federal government's intention that the states should undertake programs to provide for the recovery of stranded costs as part of unbundled retail electric service. Given these and other determinations by FERC, Pennsylvania has federal imprimatur to provide for recovery of transition costs and, therefore, the dormant Commerce Clause is not triggered. Commonwealth Court, in a more detailed analysis came to the same conclusion:

> [T]he Competition Act, and the stranded-cost provisions contained therein, do not involve the Commerce Clause because they do not discriminate against interstate commerce. Allowing the act to remain as enacted by the General Assembly is consistent with Supreme Court precedent because the practical effect of the act is to promote competition. The stranded-cost provisions, which are an integral part of Pennsylvania's plan to open its electric markets to interstate competition, cannot be examined outside of the context of the entire act. The provisions limit stranded-cost recoveries both in terms of amounts and duration, and afford no unfair advantage to Pennsylvania utilities in the new electric generation market.

*IPL v. PUC*, Pet. App. 16a.

**D. The Act Does Not Discriminate Against Interstate Commerce**

Assuming that the commerce Clause would apply, there are two tests used in analyzing the impact of the state action on interstate commerce. The first is strict scrutiny review. This applies when a state or local law "facially" discriminates against out-of-state competitors and creates "local ecoonmic protectionism." *Empire Landfill* at 333; citing *C & A Carbone, Inc. v. Clarkstown,* 511 U.S. 383, 392 (1994). The Commission submits that the Customer Choice Act does not discriminate either facially or in actuality against out-of-state suppliers of electricity.

IPL argues that the provisions of the Act allowing for recovery of stranded costs discriminate in favor of "high cost" Pennsylvania utilities and against it as an out-of-state supplier of "low cost" electricity. IPL Pet. at 9. It states that such discrimination is in violation of the Commerce Clause in that it places a burden on out-of-state generators whose potential customers must subsidize Pennsylvania utilities. *Id.* IPL has wrongly misrepresented both the purpose and the effect of the transition cost recovery provisions of the Customer Choice Act.

First, not all Pennsylvania electric utilities are high cost generators, nor is it evident that all utilities will seek full recovery of stranded costs. Stranded costs are by definition, expenses and capital costs which, for the most part, are already in the rates being paid by Pennsylvania ratepayers. Through operation of a competitive transition charge the stranded costs allowed by the Commission will be recovered from and will apply to *all* customers in a utility's service territory. Thus, from the customer's perspective, it is neutral and will not affect a customer's choice of purchasing from either an in-state supplier or an out-of-state electricity supplier.

The stranded cost charge is intended to allow utilities to recover costs which they incurred in doing business in a *fully regulated* environment. Moreover, the underlying elements of these costs (generation plant investments,

deferred taxes, post-retirement employee benefits, nuclear decommissioning costs, etc.) have been previously determined by the Commission to be prudently incurred, reasonable in amount and, therefore, fully recoverable from customers under the prior monopoly regime. The Customer Choice Act does no more than establish a *temporary* mechanism by which these prudently incurred costs may be recovered, from all customers, during the transition to a fully competitive market for the sale of electricity. Thus, it creates an open market under the new regulatory paradigm that will allow all suppliers, including Pennsylvania utilities, to compete in an open market for generation.

IPL's argument that this amounts to plain discrimination has no support in the record to say the least. The Customer Choice Act caps electric rates for a period of time and requires utilities seeking to recover stranded costs to mitigate those costs. Moreover, *subsequent* to this case the Commission reviewed the utilities' restructuring plans including claims for recovery of stranded costs. These reviews included the restructuring plan of PECO Energy. Although IPL has filed an appeal of that proceeding, it is not part of the record below. Thus, IPL's claims with respect to the amount and nature of PECO Energy's stranded costs are merely speculative. Its arguments here are based on hypothetical assumptions regarding the nature and impact of stranded cost recovery on the market for electricity in the utility's service territory.

It is noteworthy, that the restructuring plan approved by the Pennsylvania Commission for PECO Energy resulted from a settlement among the utility and representatives of its residential, industrial and commercial customers, as well as marketers and generators of electric power both inside Pennsylvania and from out-of-state.[16]

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[16] *Application of PECO Energy Company for Approval of its Restructuring Plan Under Section 2806 of the Public Utility Code,*

As a result of this settlement, effective January 1, 1999, PECO Energy's customers are elegible to shop for electricity from a number of competing suppliers of electricity. IPL is not one of these competitors. It has never applied for a license to sell electricity in Pennsylvania.

Moreover, unlike the industries in the cases relied upon by the Petitioner, the electric industry is not fully deregulated in Pennsylvania. In Pennsylvania, the other states in the process of introducing competition and at the interstate level through FERC's orders, only the *sale* of electricity is being open to competitive forces. The distribution and transmission of electric power remain regulated monopoly functions.

IPL argues that the recovery of stranded costs is discriminatory because non-incumbent, non-Pennsylvania suppliers cannot recover their stranded costs. IPL has no stranded costs because its captive customers in Indiana who have no choice of generation supplier [17] are paying *all* of its embedded and marginal costs. Nor can it be argued that the mere difference between regulation in Pennsylvania and Indiana creates a burden on interstate commerce. The courts have upheld differences in regulation between states. When a gas distribution company which served both Pennsylvania and West Virginia and its affiliated pipeline brought suit against the PUC, it argued that the Commission had discriminated against interstate commerce by denying recovery of certain costs found to be imprudently incurred. *Kentucky West Virginia Gas Co., et al. v. Pennsylvania Public Utility Commission*, 837 F.2d 600 (3rd Cir. 1988), *cert. denied*, 488 U.S. 941 (1988). The regulatory commission in West Virginia had approved recovery of its jurisdictional share

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*et al.*, PaPUC Docket Nos. R-00973953 and P-00971265, Final Order, 186 P.U.R.4th 105, (PaPUC May 14, 1998).

[17] Indiana has no customer choice law.

of the same costs. At issue was Act 74 [18] which enabled the PUC to disallow certain gas acquisition costs if they were incurred imprudently.

The court rejected the gas company's claim that this amounted to discrimination against interstate commerce:

> The commerce clause requires that states exercise their regulatory authority not in a manner exhibiting purely local favoritism in commercial concerns nor in a manner detrimental to the national concern of the free flow of gas in interstate commerce. Act 74 withstands commerce clause scrutiny under this standard because we find no evidence to indicate that it poses more than an incidental burden on interstate commerce and find instead that the Act complements the federal goal of consumer protection.

*Kentucky West,* 837 F.2d at 615. As noted above, if it does nothing else, the Customer Choice Act "complements" federal regulation of electricity through the introduction of competition to commodity sales. *See IPL v. PUC,* Pet. App. 27a-28a. ("The Competition Act, read in its entirety, is the antithesis of a statute that violates the Commerce Clause because it actually invites out-of-state competition in an area where states have been traditionally permitted to exclude such competition.") Given the absence of interference with interstate commerce, and the commonality of the Customer Choice Act with federal regulation and that of other states, there is no need to disturb the decision of the Commonwealth Court.

### E. Strong Public Policy Reasons Exist to Support the Customer Choice Act

There are a number of powerful reasons which support recovery of stranded costs. The state has an absolute and compelling interest in seeing that the necessary funds are collected to ensure that utilities which own shares in

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[18] Pennsylvania Act of May 31, 1984, No. 1984-74, 66 Pa. C.S. §§ 1307(f), 1317-18.

nuclear generating stations will have adequate funds to decommission those plants when their useful life is finished. These costs are collected in rates over the life of the plant so that all ratepayers pay a fair share. It is vitally important that utilities be financially able to decommission plants containing dangerous radioactive material.

Additionally, under the Nuclear Waste Policy Act of 1982,[19] utilities pay a usage charge for each kilowatt hour generated to provide for the eventual storage of spent nuclear fuel by the federal government. Currently spent fuel is stored at each plant site. As with the decommissioning, a failure to remove this radioactive fuel is of the highest importance for the safety of Pennsylvania.[20] Additional concerns include the maintenance of reliable service for those consumers who do not shop for electricity as well as programs for low-income persons who cannot afford the full cost of electric service.

With respect to the other above market costs which could become stranded, the state has an interest in preserving the integrity of its electric distribution utilities. Given the magnitude of the stranded cost problem, it cannot be said that these companies will be able to continue to operate as financially viable concerns without some form of recovery. Indeed, numerous parties' presented evidence on this precise issue in the subsequent restructuring proceeding before the Pennsylvania Commission. Finally, as noted above, the state has an interest in assuming that obligations undertaken by utilities as a result of the Public Utility Regulatory Policies Act of

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[19] Nuclear Waste Policy Act of 1982, Pub. L. 97-425, 96 Stat. 2201, 42 U.S.C. §§ 10101-10226.

[20] *General Motors Corp. v. Tracy*, 519 U.S. 278, 304 (1997) ("First and most important, we must recognize an obligation to proceed cautiously lest we imperil the delivery by regulated LDCs [local natural gas distribution utilities] of bundled gas to the noncompetitive captive market.").

1978 are honored. Commonwealth Court recognized these concerns. *IPL v. PUC*, Pet. App. 30a-33a.

Finally, IPL argues that distribution utilities should be required to divest themselves of their generation assets. IPL Pet. p. 25-27. While such transactions could result from the restructuring process,[21] the Customer Choice Act does not require it. In fact, FERC does not reqiure it of utilities with respect to their wholesale sales of electricity. In addition, there was no evidence in the record of this proceeding that divestiture would promote interstate commerce.

The Commission submits that the public safety concerns set forth above tip the scales in favor of the constitutionality of the stranded recovery provisions in the Customer Choice Act.

## CONCLUSION

WHEREFORE, the Pennsylvania Public Utility Commission requests the Honorable Court for an order denying the Petition for a Writ of *Certiorari* of Indianapolis Power and Light Company.

Respectfully submitted,

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[21] Some Pennsylvania utilities have voluntarily chosen to sell-off generation assets.